

- PN-ABS-939
ISS 90916

MAHAWELI ENTERPRISE DEVELOPMENT

MED/EIED PROJECT

(USAID/Sri Lanka Project No. 383 - 0090)
(Contract No. C-00-0031-00)

SUSTAINABILITY ASSESSMENT OF MAHAWELI ENTERPRISE DEVELOPMENT PROJECT

by
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May, 1994

Report 3/1994



INTERNATIONAL SCIENCE AND TECHNOLOGY INSTITUTE, INC.

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Mahaweli Enterprise Development (MED)

The development of the natural and human resources of the Mahaweli river basin is a high priority of the Government of Sri Lanka. The construction of physical infrastructure, the settlement of the land and the formation of the agricultural production base are largely completed. The challenge now is to build a diverse, dynamic economy capable of steadily raising Mahaweli family incomes. In meeting this challenge, the private sector - farmers, entrepreneurs, companies, community groups, non-governmental organizations - has an important role to play.

MED is a project of the Mahaweli Authority of Sri Lanka and the United States Agency for International Development. MED promotes investment and employment generation by the private sector in non-farm economic activities and contract outgrower programs producing diversified crops. MED does this by: (i) developing technical, marketing, financial and other services which assist self-employed individuals, microenterprises and companies to start and improve their businesses; (ii) developing entrepreneur associations and other participatory groups; and (iii) carrying out studies and analyses to improve the frameworks for development in the Mahaweli areas.

The Employment, Investment and Enterprise Development (EIED) Division of the Mahaweli Authority is the MED implementing agency. Technical consultancy is provided by a consortium led by the International Science and Technology Institute, Inc. (ISTI), and including Agroskills, Development Alternatives, Ernst and Young, High Value Horticulture and Sparks Commodities.

PREFACE

This study addresses the key issue of the sustainability of services and benefit streams developed with MED support. It focuses on the three components of the project which have been most effective and which appear to hold the most potential for long term impact - Business Centers, Savings and Credit Societies, and contract outgrower farming arrangements. It proposes actions with regard to each of these to enhance their sustainability.

The author, Dr Richard Huntington, has a long experience in rural enterprise development and in the analysis of sustainability issues.

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SUMMARY AND RECOMMENDATIONS

SUMMARY

The Mahaweli Enterprise Development Project (MED) is a five-year long, \$20 million (including USAID and Government of Sri Lanka contributions) effort to increase the private sector investment and employment in the large rural resettlement areas in the dry zone administered by the Mahaweli Authority. The implementing agency is the Employment, Investment and Enterprise Development (EIED) Division, a small, special entity of the Mahaweli Authority with the responsibility for fostering private sector development.

This sustainability assessment is concerned with the practical issue of how to ensure the continuation of the benefits of a specific project once the donor resources are withdrawn. Sustainability, in this sense, stresses the extension of the project's "stream of benefits" into the future. This continuation of the "stream of benefits" depends on three factors: (a) the effectiveness of and demand for the services provided by the project; (b) the financial sustainability of the service delivery mechanisms; and (c) the strength and commitment of the participating institutions. This assessment establishes which project-supported services providing valued benefits to the targeted beneficiaries should be continued after the end of the project. For each of these service areas, we then look at the requirements and alternatives for establishing, to the extent possible, the financial and institutional sustainability.

According to the project design, MED would generate 10,000 new jobs in the Mahaweli. The strategy in the design was for 75% of these jobs to be created by the establishment of 10 large agribusiness commercial farms, and for the remaining 25% to be created in small and micro enterprises and through outgrower arrangements. However, it has turned out that the opportunities to create employment and raise incomes lie much more in the areas of micro enterprise and contract farming than in large agribusinesses. In a stunning reversal of the project targets, only 15% of the jobs have been created by medium and large investments, while the remainder have been generated by micro-enterprises, small enterprises and contract outgrower farmer arrangements.

This reorientation has implications for sustainability. The Project Paper predicted that private sector activity, especially with these large and active investors, would reach such a critical mass that further investment and economic development would be largely self-generating. Regarding project services, as these were primarily start-up services for large profitable enterprises, there would be no need for such services to continue by the end of the project. However, with most of the employment and income gains coming from large numbers of smaller enterprises, enterprises that typically start up and fail at a rate of 15%-20% per year, there is a continued need for services that support the start-up of new enterprises, and the growth of micro and small enterprises. This need to institutionalize services for micro and small enterprise development was foreseen in the project design, but assumed to be at a much lower level than has evolved.

Project activities that should be the focus of the sustainability effort between now and the end of the project are the efforts to establish the following capabilities in the Mahaweli areas:

- o A capacity to support the continuing emergence and growth of rural micro and small enterprises;
- o A network of strong and effective rural credit institutions; and
- o An established framework for linking Mahaweli smallholder farmers to outside investors and markets through contract farming, or, outgrower arrangements.

The task is largely an institutional development effort focused on sustaining the 12 Field Business Centres, the network of 66 Savings and Credit Societies, and some institutionalized capacity to facilitate outgrower arrangements.

RECOMMENDATIONS

1. Field Business Centres

MED/EIED should implement the program for strengthening the Field Business Centres as focal points of services for microenterprises. This recommendation includes the efforts to link and catalyze other institutions (panels of experts, NGOs, private associations, government line agencies) with the FBC programs, staff training and measures to increase efficiencies and cost recovery.

At the same time, MED/EIED should carry out feasibility studies for private, for-profit business service firms in certain of the most promising locations. Based on the results of these feasibility studies, MED/EIED could support the establishment of one or two private business service firms that might work closely or share the premises with a Field Business Centre.

2. Rural Credit Program

Complete the process that has begun. There is a monumental institutional development task to be completed on three levels. The Savings and Credit Societies are still fragile, infant organizations. Continue to strengthen the SCSs; complete formal registration procedures for all 66 SCSs that have been formed so far. Begin formation of five Unions of SCSs. Then strengthen and assist Unions to become fully and effectively operational. Finally, establish an apex institution, if considered appropriate after further analysis.

3. Outgrower Arrangements

Develop an action plan to maximize the sustainability of the outgrower program. The plan should be developed after completing the present round of discussions with the companies and a study of contract farming in the Mahaweli. The study would identify the measures and

facilitation services to maintain the competitiveness of Mahaweli outgrowers. The lesson from the literature on contract farming and from the MED/EIED experience to date is that it works very well in some types of production and marketing situations and with certain types of crops, and not at all in other situations. Furthermore, situations favorable to contract farming are very specific to a region, and are the result of the interplay of many variables.

The project has assisted to raise the number of contract outgrowers in from 770 in 1989 to 6,474 in 1993 and has become a major force for crop diversification in the Mahaweli areas. In seeking to sustain this component of employment generation, it is important to stress that the goal is not necessarily to keep the present outgrower operations in the Mahaweli in perpetuity, but to establish a framework which can continue to facilitate new outgrower arrangements and to maintain the competitiveness of Mahaweli growers.

4. Project Extension

The government of Sri Lanka has requested a 21 month extension of USAID support for the MED Project, through the end of 1996. The major objective of activities during the extension period should be to strengthen the sustainability of the services which have been effective (business centres, rural credit, contract outgrower farming). The program for this period should be based on the gradual phasing out of support in ways consistent with the institutional development nature of the objective.

1. INTRODUCTION

1.1 SUSTAINABILITY: A WORKING DEFINITION

Sustainability is a promiscuous word chasing shamelessly after a disparate assortment of meanings. Workshops and studies on the topic often struggle painfully on preliminary definitional issues; and many practitioners despair over the multiplicity of meanings attached to the concept. In his recent sustainability assessment of the MARD Project, Goldensohn provides a service by reminding the reader that part of the multiplicity of meanings derives legitimately from multiple professional perspectives -- economic, environmental, and institutional.¹ The problem of multiple meanings of key operational concepts is more common than often realized. A recent article on corporate databases reports that the managers of a major U.S. railroad company struggle with multiple definitions of "train"; and the professional staff of the United States Department of Agriculture cannot agree on the definition of "farm".² We need neither lament nor attempt to solve the multivalent nature of the concept of sustainability. Rather, we can start with a practical working notion, accepting that other facets of the concept will emerge during the discussion.

Stream of Benefits

We concern ourselves in this assessment with the practical problem of how to ensure the continuation of the benefits of a specific project once the donor resources are withdrawn. Sustainability, in this sense, stresses the extension of the project's "stream of benefits" into the future. This continuation of the "stream of benefits" depends on three factors.

- o The appropriateness and effectiveness of the services provided by the project;
- o The financial sustainability of the service delivery mechanisms; and
- o The strength and commitment of the participating institutions.

Appropriate Services

Supply-driven services are not sustainable. The appropriateness and effectiveness of the services provided comprises the first necessary condition of sustainability. Services that are not appropriate or effective in the first place will not be sustained later. There will simply be no takers for such services, even if they are delivered free. Project benefits must be in demand in order for their delivery to be sustainable. The first task in assessing a project's sustainability is to be certain that the services of the project are effective and desired by the beneficiaries. It is important to remember how often this is not the case, that many projects, especially ambitious rural development projects, fail to achieve their stated targets, or belatedly discover that they are operating under assumptions that have proven false, either due to project design inadequacy or to changing political or climatic circumstances. In these not uncommon situations, sustainability is a moot point. One cannot and should not attempt to "sustain" that which is ineffective in the first place. The first task of a sustainability assessment is to determine which, or if any, services are worth continuing.

Financial Sustainability

Financial sustainability is the central requirement for the continuation of the stream of benefits, the *sine qua non* of sustainability. How will these services be paid for once the donor project has ended? Here we have a range of difficult and potentially complementary options to consider.

- o Can the government include the recurrent costs as a regular feature of its budget? Should it? Is it likely to continue such support in the longer term?
- o Should the recipients themselves pay the cost of the received services? Can they afford to pay, and are the fees for service likely to provide a secure base for financial sustainability? If so, will the benefits remain directed at the targeted (poorer) recipients? One needs to determine whether the services are primarily economic or whether they comprise an element of social infrastructure?
- o Should other donor agencies take on the cost of the provision of the services? Does this increase the long-term dependent and unsustainable nature of the activity? Or does it appropriately continue a process of development toward ultimate sustainability?

What these questions make clear is that one should avoid the common tendency to over-simplify the financial sustainability issue. It is not simply a question of charging for services, "turning the operation over to the private sector", securing grants from other donors, or getting the service ensconced as a line item in the government's regular budget. There are tough trade-offs and down sides to all options.

An additional and important aspect of financial sustainability is the question of how efficiently services are being provided. During the period of donor support, effective services may be delivered, but at a cost that is too high in the long run. A key activity in preparing for sustainability is to progressively sharpen the efficiency of service delivery so that a level of results can be sustained using less resources.

Institutional Sustainability

The institutional component is the most fragile aspect of long term sustainability. The most important institutional issue is "ownership". Is the program truly accepted by the national institution, governmental or non-governmental, that is responsible for continued implementation?

Additionally, there are a number of questions to be addressed and alternatives to be considered. What is the correct long-term institutional home or homes for project services? What aspects of service delivery should come from government, NGOs, or business institutions, respectively? Is there one appropriate institutional home or several?

Institutional development, especially in relatively resource poor rural areas, is a difficult task. Such institutions need to be capable of efficient management, able to provide technically competent assistance, and able to effectively link governmental and private resources with the real and felt needs of rural clients and beneficiaries. This is a taller order than is often acknowledged. Government services to rural areas are often decreasingly responsive the further one travels from the capital. Rural businesses are often geared for short-term profits based on rapidly shifting targets of opportunity in seasonally based trading. Banks in rural areas have a difficult time providing useful services to a broad rural clientele at a cost and risk acceptable to the banks. NGOs can be more fragile in reality and more limited in their outreach capability than is readily apparent; and their funding sources are often from external and uncertain sources. All of these rural institutions exist and are sustainable in themselves, but they are not easily transformed into entities capable of delivering the stipulated "stream of benefits" in a sustainable fashion.

Each of these three key components -- appropriateness of (and demand for) services, financial sustainability of service delivery mechanisms, and institutional sustainability -- requires a composite response and, by definition, a longer term strategy.

In this sustainability assessment of the Mahaweli Enterprise Development Project, we will first assess what are the appropriate and effective MED/EIED service areas that should and can be sustained. Then for each of these services, we will look closely at the options for financial and institutional sustainability that maximize the chances that they (or adaptive mutations of them) can continue to be provided to the targeted beneficiaries for the foreseeable future.

1.2 THE MAHAWELI ENTERPRISE DEVELOPMENT PROJECT (MED)

The Mahaweli Enterprise Development Project (MED) is a five-year long, \$20 million (USAID and GSL) effort to increase the private sector investment and employment in the large rural resettlement areas in the dry zone administered by the Mahaweli Authority. The implementing agency is the Employment, Investment and Enterprise Development (EIED) Division, a small, special entity of the Mahaweli Authority with the responsibility for fostering private sector development. EIED was established in 1986 on the urging and with the assistance of USAID. The main USAID contractor, the International Science and Technology Institute, Inc. (ISTI) has provided resident advisors in areas such as rural credit, agribusiness, marketing, technology, and small and micro-enterprise development, as well as short-term specialized consultants.

MED is the culminating project of a series of USAID-supported activities and investments for the ambitious Sri Lankan project to mobilize the resources of the nation's longest river in order to provide irrigated land for half a million poor settlers in the hitherto sparsely populated dry zone, and to provide hydroelectric power to meet expanding urban and industrial electricity demands. Since 1978, USAID has obligated over \$200 million in a series of projects, predominantly in System B, supporting the Mahaweli program. In an important sense, the MED Project itself was intended to contribute to the sustainability of A.I.D.'s overall investment in the Mahaweli region by generating private enterprise activity that could provide employment for

the second generation of settler families and facilitate economic diversification and fuller economic integration of the region with the national economy. The project's goal was expressed in terms of employment creation, employment opportunities that would offer settlers alternatives (and supplements) to the production of paddy on their small irrigated plots.

The MED Project covers Mahaweli Systems B, C, H, Uda Walawe, and Kotmale. This is in contrast to most earlier USAID Mahaweli projects which concentrated on System B. As an enterprise development project, MED was expected to contribute significantly to the creation of 10,000 jobs. The Project Paper anticipated that 87% of these jobs would be created through the inward investment in medium and large enterprises, especially agribusiness operations exporting non-traditional crops to Colombo and, to some extent, overseas. The MED/EIED program to increase employment consists of the three following types of activity.

- o Encourage and Support the Development of Medium and Large Enterprises** Many MED/EIED activities promote "inward investment" in new medium and large enterprises that would generate significant employment opportunities and link the relatively remote Mahaweli to external economic resources and markets. MED engages in investment promotion activities, providing potential investors with advisory services and, in a few special cases, with Pre Investment Programs. The activity in this medium and large enterprise (MLE) area focusses understandably on agribusiness opportunities, including outgrower programs.
- o Support the Growth of Micro- and Small Enterprises** MED/EIED activities support the growth of self-employment, and of micro-, and small enterprises that provide needed services to the settler population. Under the MED Project, the EIED has established twelve Field Business Centres throughout the Mahaweli, whose combined MED and EIED staff provide financial, business, technical, and marketing advice to entrepreneurs, arrange for training, facilitate entrepreneurs' access to rural financial institutions, provide liaison between entrepreneurs and appropriate government entities, and assist in the formation of associations of entrepreneurs and in the establishment of Savings and Credit Societies.
- o Improve the Policy Environment** MED has worked with the government and especially with the Mahaweli Authority of Sri Lanka (MASL), to improve the policy environment necessary for the success of MED objectives. Initially, most important were the efforts to secure land tenure for businesses, large and small. Without secure title to land, business development and investment is severely hindered. Currently, most important are MED efforts to assist the restructuring of the MASL in order to strengthen the long term sustainability of the Mahaweli river basin resources.

The Project Paper handled the issue of sustainability by assuming that the MED Project would lead the Mahaweli to a sort of economic "take off" with continued investment and employment creation being self-generated by the "agglomeration economy", by the natural momentum of the critical mass of private sector investment and activity. Regarding the services delivered under MED, the PP stressed (under its discussion of recurrent costs) that most of the services will be start-up services to pioneer medium and large enterprises, and by the end of the project, these large enterprises will be beyond needing such help.

In the small and micro-enterprise area, the Project Paper highlighted the necessity of institutionalizing small business advisory service delivery in order to continue the provision of benefits:

The outputs of the project will consist of the various delivered services to private enterprises described above, and for some activities, the institutionalization of an ongoing-market oriented service delivery capability.

However, since the SSE sector was assumed to provide only about 10% of the jobs created, the Project Paper suggested that, in terms of the recurrent costs issue, EIED could manage service provision at this level.

For the credit program, the Project Paper anticipated, correctly, that the group credit institutions, if properly and successfully implemented and established, would be self-sustaining.

1.3 LESSONS LEARNED BY THE MED PROJECT

Even the most thoroughly designed projects are based on levels of knowledge that are dwarfed by the knowledge gained during project implementation. When looking toward ultimate sustainability, it is important to incorporate the implementation learning process into the plans. This sustainability assessment is done within the framework of decisions already taken by MED, EIED, MASL and USAID as a result of the lessons learned during the first three years of project implementation.

There has been an important incremental process of learning and adaptation already in place with MED and with the EIED since the outset. The sustainability of MED supported activities and benefits is enhanced to the extent that it continues to build on this learning process. The essence of this process has been one of assessing what works and what doesn't, what assumptions of the project design have proven accurate, which ones have been shown to be faulty, and discontinuing the ineffective services and strengthening appropriate ones. The result is a sharper focus on a fewer number of services delivered to better-defined target client groups.

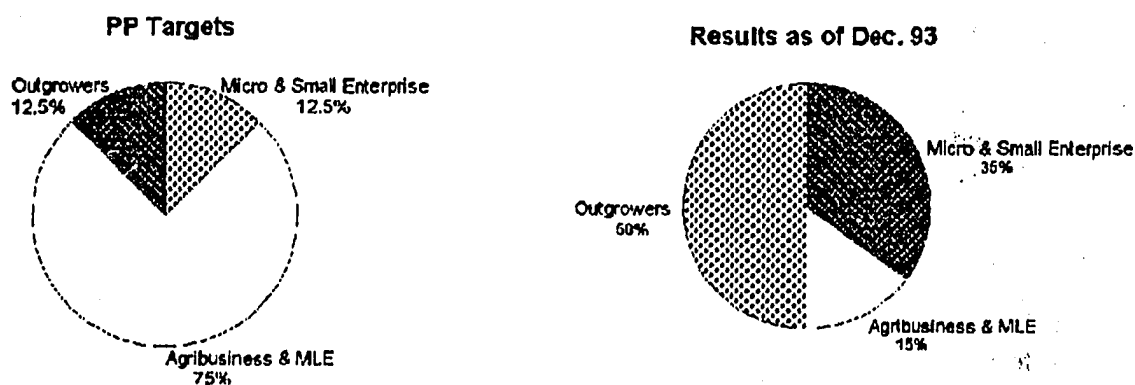
Sharper focus, fewer services, more defined target client groups

Project activities have undergone a steady reorientation:

- o Toward a focus on contract farming outgrower schemes, and away from the design emphasis to establish large commercial agribusinesses;
- o Toward a focus on micro- and small enterprises, and away from the design emphasis on large and medium enterprises; this has included developing technology transfer and marketing services, as well as credit services, for microenterprises; the design emphasized credit services for micro- and small enterprises and technology and marketing services for large and medium enterprises;
- o Toward a focus on "home grown" entrepreneurs and away from the design emphasis on inward investment; this in turn has increased the emphasis on marketing within Sri Lanka, on indirect (as opposed to direct) export marketing, and on backward and forward linkages between the agricultural and non-farm sectors in the Mahaweli;

Although the MED/EIED program will likely surpass its employment target of 10,000 jobs created, it will do so with a very different configuration from that intended in the Project Paper. By the end of CY 1993, 10,000 had been created in MED assisted enterprises. Only 15% of these jobs were generated by fixed farm agribusinesses and other MLEs, compared to the 75% predicted in the project design. Small and micro enterprises, on the other hand, account for about 35% of the jobs created, rather than the predicted 12%. The greatest increase over the original targets is in the area of contract farming, or outgrower schemes. This accounts for 50% of all jobs created rather than the predicted 12%.

Fig. 1. Changes in the Distribution of Employment Generation



These changes in focus and results reflect a pragmatic shift of project resources to leverage the project activities that have shown early results, and the gradual abandonment of activities where results were not nearly commensurate with the level of project resources devoted to them.

One needs to consider why the larger, inward investment, and agribusiness support programs faltered, despite the devotion of considerable project resources to them during the first two project years.

- o First, with hindsight it is clear that the original design was flawed in not appreciating the deep cultural - social - political commitment to small holder agriculture and the consequent political unlikelihood of turning over large tracts of land to investors while there are still many potential poor settlers waiting for their opportunity.
- o Second, and related to the above, progress has been very slow and uncertain in the area of assigning long-term leases to large commercial farms.
- o Third, potential investors, many of whom are holding companies with interests in a range of sectors, have found better investment opportunities in non-agricultural activities, especially with the strong general performance of the Sri Lankan economy during the past few years.

One other sustainability issue of a different order relates to MED/EIED activities in the area of policy support to MASL. Earlier in the project these activities were concerned with "opening up" the Mahaweli area to private sector and NGO participation, and especially with the issue of land leases for business operations. These policy objectives have been largely accomplished (although implementation is a slow process). Recently, MED/EIED have been requested by MASL to provide assistance on issues pertaining to the sustainability of the overall Mahaweli Accelerated Development Programme. In this light, MED/EIED have provided assistance to the task forces on Mahaweli restructuring, concerned with how to assure the continued provision of water and land resources that support the rural development, and how to provide appropriate services to the settlers most efficiently.

The changes in MED/EIED focus are reflected in the approved MED/EIED Workplan for 1994, and reaffirmed by the results of the broader MASL effort to plan its own restructuring. in a sustainable fashion as part of the preparation for a proposed World Bank funded project.

What should be sustained?

The reorientation of the MED/EIED program, reflecting a more realistic understanding of the medium term private sector investment and employment possibilities for the Mahaweli, makes the question of sustainability more difficult than anticipated in the project's design. As stated previously, the project design, focusing on generating the increased employment and improved incomes from a smaller number of larger enterprises, could assume that much of this effort could be more or less self-sustaining by the end of the project. But sustaining the investment,

employment, and income levels with a healthy small and micro-enterprise economy requires a higher level of continued business development support. Small and micro enterprises have a higher "turnover" rate, requiring a permanent service of support for new enterprise development and small enterprise growth.

What emerges from the evolution of the MED/EIED program is a fairly clear picture of what it is that should, to the extent possible, be sustained following the end of USAID project support. The three programs that should be the focus of the sustainability effort are the following:

- o A capacity to support the continuing emergence and growth of rural micro and small enterprises;
- o A network of strong and effective rural credit institutions; and
- o An established framework for linking Mahaweli smallholder farmers to outside investors and markets through contract farming, or, outgrower arrangements.

This report will consider in turn the options for continuing these three programs and the "stream of benefits" they provide to the settlers of the Mahaweli.

2. SUSTAINING THE FIELD BUSINESS CENTRES

The Field Business Centres play a major role in providing for business advisory (including technology, training and marketing) services for micro- and small enterprises. They also play a major role in the credit programs and, depending on the location of the Center, an important role in contract farming arrangements. In this section, we will discuss the institutional and financial sustainability options for the FBCs and their services, with little mention of their roles regarding credit and contract farming, which will be discussed in the ensuing sections.

2.1 PRESENT SITUATION

The main organizational vehicle of the MED/EIED program, as it has evolved over the past three years, is the network of twelve Field Business Centres (FBC) that has been established rural centres in the Mahaweli systems. They were an important design feature in the Project Paper and the individual FBCs are the focal points for delivery of MED/EIED services. As the project emphasis has shifted toward supporting the growth of micro and small enterprises, these FBCs have become even more critical to the achievement of project purposes. The FBCs have played a supporting role in the efforts to encourage inward investment in larger enterprises. In that effort, their role has been to follow-up and support the investment promotion and investor identification activities that were spearheaded by senior staff at MED/EIED headquarters in Colombo. Regarding micro and small enterprise development efforts, by contrast, the Field Business Centres are in the driver's seat, with back-up support required from MED/EIED

headquarters. With the main focus of MED/EIED on micro and small enterprise development, the FBCs have emerged as the primary effective delivery mechanism for MED/EIED benefits. The question of providing for the sustainability of FBC activities, of finding a way to assure the continuation of their services to the emerging entrepreneurs of their Mahaweli locales yields no easy answers.

The most important and striking characteristic of these Field Business Centres is that they are customer-oriented, business-like service operations, rather than rural government offices. Each FBC has developed, and continues to develop, a portfolio of clients. They continue to keep track of their clients, helping them grow and deal with new problems that are faced at stages of business development. Clients are tracked in a client-based information system. Each client is given a client number at the time of the first consultancy and basic information on the enterprise and its number of employees is entered. Each subsequent service from the FBC to this client is simply recorded in the course of business. Any changes in the numbers of employees (or credit) are recorded simply on a change of status form. Additionally, every quarter, the MIS produces a list for each FBC of those clients for whom it has recorded no change of status during the previous six months.

The typical FBC is situated in premises in reasonable proximity to local commercial activity and prominently accessible to entrepreneurs. The facilities have in general a pleasant customer-friendly and professional appearance, and are for the most part reasonably well equipped with computer, printer, typewriters, fax and photocopy machines. They intentionally have established more the appearance of business centers than of government offices. Each FBC presently has a combined staff which includes one Field Business Consultant and a secretary supplied under the MED project, and between one and three field officers from EIED, one of whom is the director of the FBC. The director has a four-wheel drive vehicle provided by the government. The MED Business Consultant has a motorbike provided by the project.

One important decision in the direction of sustainability was taken by MED in 1992, namely the integration of the MED Field Business Centres with the activities of the EIED Field Officers into one team. Starting from that year, each business centre's staff included both EIED and MED field personnel, who together formulated the annual workplan and targets for their FBC, and together manage the monitoring and information system that tracks the FBC's record in meeting these targets. The successful implementation of this integration of MED and EIED field activity means that the sustainability question today is how to continue the activities of the FBC minus the MED personnel; rather than, as it might have been, how to find or create wholesale an institutional home for the entirely project-funded and operated FBC apparatus.

The "one team" approach takes various working forms in the FBCs. While the command is unified in all FBCs, a number of the FBCs tend to divide the relatively heavy workload between the EIED officer and the MED consultant so that the MED consultant takes the lead in much of the business advice and loan facilitation work, while the EIED officer tends to take the lead in the more government-oriented tasks such as securing leases, on one hand, and facilitating the outgrower programs, commercial farms, and medium and large scale investments in the area.

In other words, following up on directives that come from headquarters, to help smooth the way for these larger enterprises. This division of tasks is a natural one, maximizing the comparative advantages of skills and networks of each officer. This is not universally the style of FBC operation, however. In some, the EIED and MED officers work more closely together, covering the full range of tasks; in others, they have divided the work geographically, and each handles the clients in his or her assigned territory, cooperating on the reporting and monitoring task. However, in most instances, the FBC staff has taken the easier route of each doing what he or she is best suited for. The implication for sustainability of this work pattern is that, with the end of MED, the EIED field staff are not all prepared to take over the full operation of their FBCs.

The accomplishments of the Field Business Centres are impressive. As a typical example, the Girandurukotte FBC in System C, with one MED Consultant and one EIED officer (supported by a MED secretary), created 165 new full time small enterprise jobs during 1993 through providing advice and service to a total of over 200 clients. Additionally, they arranged a total of 69 loans through three credit mechanisms (directly with banks, to banks through Savings and Credit Societies, and with the Mahaweli Venture Capital Company) with a total value of 2.4 million rupees. They also formed three Savings and Credit Associations with a total of 45 members, facilitated the transfer of over 300 commercial small enterprise plots, and directly delivered or facilitated the arrangements for a total of seven training courses serving over 150 trainees.³

Most important, these accomplishments are against specific targets identified in advance, focused targets that result from their strategic analysis of the previous year's results. Furthermore, these accomplishments are appropriately documented and monitored through their computerized MIS. The MIS is important as a self-management tool because it creates an up to date quarterly record of their accomplishments vis a vis their targets, leading them to modify their efforts during the year in order to achieve the desired results.

Such accomplishments are multiplied twelve times, so that in total the FBCs annually assist their client enterprises to create over 2,000 new full and part time jobs. Over one-third (3,000) of the total number of enterprises in the Mahaweli are clients of the FBCs (not including those clients who are still only aspiring entrepreneurs). On the important credit side, the FBC staff facilitate the submission of over 750 loans per year with a value of over 25 million rupees. This is the stream of benefits flowing to micro and small enterprises that needs to be sustained for the foreseeable future -- 2,000 new jobs, Rs. 25 million in credit, advisory services to 3,000 enterprises -- year in and year out.⁴

What are the strengths of the Field Business Centres that explain their success, and which therefore need to be maintained for the future?

- o **Field Location** MED/EIED, through these rural based centers, delivers these services directly to the rural entrepreneurs out where they live and work. The full time residence of the MED business consultant and EIED officers in the Mahaweli system where they

work also maximizes their understanding of their clients, of business possibilities, and of those business opportunities that, while attractive, are not realistic possibilities. The Field Business Centres have achieved a certain degree of local rootedness, even after just a few years of operation.

- o **Facilities** The FBCs provide facilities and services to entrepreneurs that are not easily available in these rural areas. Telephone lines, fax machines, photocopiers, and computers bring some necessary urban type services to rural business persons.
- o **Mahaweli Affiliation** It is also useful that they are associated with the Mahaweli Authority and that part of their staff are Mahaweli officers. Facilitation with the government apparatus is one of the important needs of micro-entrepreneurs unfamiliar with government structures. This affiliation may be less important in the future, but for now, given the ubiquitousness of the Mahaweli Authority in the systems, the affiliation is a plus. The role of the EIED Field Officers are particularly important in this facilitation.
- o **MED Business Consultant** Without disparaging the competence and dedication of the EIED field officers, it is important to stress that the presence of the MED business consultants is important. These people are particularly well qualified and articulate. They have an air and credentials that inspire a degree of confidence on the part of local banking officials and business persons. It would be difficult to provide persons of their calibre to remote Mahaweli areas on the public salary scale. They provide a businesslike atmosphere and critical professional expertise to the FBC.
- o **Planning and Management Systems** The organization of FBC activities according to an annual strategic workplan with quarterly targets is an important factor in FBC effectiveness and efficiency. Not that government agencies do not have workplans and targets, but such targets and directives in the public sector generally are set at higher levels and are handed down to field personnel. There is an important sense in which the FBCs establish their own targets and strategies for meeting them. Although this is done in consultation with MED/EIED headquarters, there is an important element of decentralization of responsibility in the FBCs which creates a sense of "ownership" among the field staff.

A plan for sustainability need not replicate the exact present arrangement for the future, but it must provide in some way these characteristic strengths that are responsible for the FBC's effectiveness.

2.2 OPTIONS FOR SUSTAINING THE FIELD BUSINESS CENTRES

The services provided by the Field Business Centres are a key element of what we wish to continue after the end of the MED Project, and the FBCs themselves, in some form, appear to be an effective and viable service delivery mechanism. They have steadily become more efficient and the project have internalized its learning and this process continues. There are three options for strategies to sustain the FBCs. We will present and analyze each in terms of its financial and institutional sustainability.

But first, it is important to consider some general lessons from the literature on similar small business development centers in other parts of the world.⁷ Regarding financial sustainability, nowhere in the world do such centers serving rural entrepreneurs and aspiring entrepreneurs, survive fully off the fees they charge to their clients. This is reported to be the case throughout the United States, in the United Kingdom, and in Eastern Europe. It is of course possible for business centers to support themselves by providing advisory services to private clients, but not if they are dedicated in a significant way to helping new entrepreneurs. In developed countries, small business centers survive on a combination of fees for service, grants from government (national and/or local), support from local business associations and chambers of commerce, or as part of a local university (which also receives a government grant for providing these services). In developing countries (and "economies in transition"), small business centers tend to continue to rely largely on support from international donors, although not necessarily a single donor or the original supporting donor. The example of the Sri Lanka Business Development Centre, a private, non profit organization set up by USAID to provide business services to small and micro enterprises, is not encouraging. Its stipulated clientele is unable to afford its fees for service, and it faces financial crises as it searches for support from one external donor after another.

Regarding institutional arrangements, there are three common models. Small business centers are often government agencies, providing fledgling entrepreneurs with assistance as a means of strengthening the local economy and assuring that "new blood" continues to enter the business community. This is a government service not unlike the services of a government agricultural extension department. The second common model is the business center as an outreach program of a community-based university or of a vocational education institute. The third common institutional home for the provision of such services is the private business association or chamber of commerce.

Obviously these forms of funding and institutional form cannot be simply replicated in the Mahaweli, but they serve to suggest what are the likely constraints and realistic limitations to the sustainability of the MED/EIED Field Business Centres. Within this perspective, three logical options emerge for the Field Business Centres: (a) FBCs serve as the field offices of the EIED, largely funded by government, (b) FBCs as private, for-profit businesses serving the Mahaweli and nearby commercial centers; and (c) the FBCs as a public/private sector hybrid.

The FBC as a Government Service

The Field Business Centres could continue as public sector entities as the field offices of the EIED, providing business advisory services to entrepreneurs and encouraging and coordinating NGOs and other government programs to deliver complementary business development services. This option is the direct continuation and evolution of the present situation, and as such builds on the momentum of the MED Project. It is the simplest option both in terms of institutional arrangement and of future financing. This public sector option is foreshadowed to a certain extent, by the decision to integrate the programs of the MED field business consultants and the EIED field officers under the umbrella of Field Business Centres.

As mentioned above, business centers focusing mainly on the start-up and development of micro- and small enterprises are often and appropriately (given the public good nature of most of the services) run as government activities, with varying forms of public-private linkages, elsewhere in the world. Depending on the final outcome of the process of Mahaweli restructuring, the Field Business Centres could either continue to be operated by EIED, or be handed over to a different government agency, although it is not clear just what other line ministry or agency has responsibility for small and microenterprise development in rural areas. The discussions of the Mahaweli Restructuring task force regarding options for business promotion activities, view it as an appropriate public sector activity.

Financial and Institutional Sustainability

This option possesses the strong likelihood of financial sustainability. The EIED field officers are already civil servants and the Field Business Centres are, for the most part established in government quarters. Staff salaries, office rent, equipment maintenance, and transportation are covered for the foreseeable future on the government budget.

This public sector option should include the recovery of costs as a supplement to the government support of the FBC. The FBC sets sliding schedules of fees for services such as preparation of loan applications or business plans, based on the abilities of different categories of clients to pay, or on the size of the loan or proposed investment project. Experience worldwide has shown that such fees increase the perceived value of the services to the beneficiaries, and inculcate a businesslike appreciation of the importance of such services. Similarly, the FBC charges clients for use of the fax, phone, and photocopier, using such receipts for maintenance and replacement costs. Training courses should also charge modest fees in order to recover the costs of refreshments, hall rental, and preparation of special materials.

Regarding institutional sustainability, this public sector option can and should include the facilitation and coordination of local NGOs and private business associations to carry out entrepreneurship training and support programs. In these instances, the role of the government FBC might be to provide transportation or other support to programs delivered and funded by the private entities.

When considering this public sector option it is important to remember the reality of the Mahaweli as a relatively recent resettlement area, lacking the sizable towns, chambers of commerce, community universities, and other institutions that normally might support a more private sector institutional structure for the FBCs. Also, the public sector home for the FBCs is a special government division devoted to private sector development. EIED is a small specialized government unit dedicated to private sector development, rather than a large generalized bureaucracy.

Strategies for Phasing Out and Replacing MED Resources

How, within this public sector operation, can one effectively operate the FBCs without the resources of the MED Project? What resources can be brought in to permanently fill this gap? The challenge is to develop more efficient management systems, upgrade the human skills, and create a synergy by working more fully with and through local associations, NGOs, and government line agencies. The following strategies would greatly enhance the future abilities of the FBCs to continue to provide the kinds of useful and valued benefits presently being delivered with MED support.

Training for EIED Field Officers

What is required is a gradual reorientation of the roles of EIED officers' responsibilities in the FBC, and at headquarters. EIED field officers must be specifically trained and made responsible for the business advising and credit advising activity.

A number of the present EIED officers are already operating very effectively in this mode, but others presently concern themselves with those activities that are to be de-emphasized, i.e. industrial parks, commercial farms, leases, and so on. Furthermore, most have not been specifically trained for the business advisory role, and there has been a general tendency to have the MED consultant take the lead in that area. It is important that each FBC has one more or less dynamic individual, who has the skills to command respect among the entrepreneurs and the banking officials in the area.

The MED project should organize a series of formal training sessions for the selected EIED Field Officers. This training should stress the details of loan applications, business plans, and small feasibility studies, as well as broader concepts of business development and even enhanced communication skills. This formal training should be supported by organizing the FBC workload so as to maximize the joint working together of the EIED Officer and the MED Consultant. In this way the training will be put to immediate use, and the skills gained will be strengthened. This training program will need to work against the prevailing culture of training for government officers which too often involve overseas courses, and then little opportunity to utilize the skills upon return. What is needed in this case is a series of formal short courses, delivered in-country, integrated with a planned program of on the job training and assumption of full responsibility for business advising and all other FBC activities.

Mobilization of Other Resources

Continuing and enhancing present trends, the FBCs will coordinate and facilitate the activities of a variety of other persons and institutions providing services to strengthen enterprise development. This coordination and facilitation role might best be put in the hands of a EIED Officer stationed at the RPM complex in each system. The sustainability implications of this strategy extend beyond the provision of supplementary resources. There is also a diversification of institutions providing business development services to the Mahaweli entrepreneurs. In the long run, this increases the likelihood that benefits from some source will always reach the Mahaweli. In the recent past, the MASL was not very open to having other such institutions operating in the Mahaweli, however, there is now a real interest and beginning to the process of "opening up" the Mahaweli. The other resources that can be mobilized and coordinated are:

- o **Local Panels of Experts.** In each system, or each FBC a panel of experts in business, banking, and technologies could be created which could periodically meet to provide advice to FBC clients, and, in the process, to the EIED officers. This panel would essentially be a local service organization and could be registered as such. It could also serve as an advisory board for the Field Business Centre itself. This arrangement would also help inform the panel members of the entrepreneurial activities near where they live and work.
- o **Non-governmental Organizations.** There are a number of NGOs engaged in training and follow-up activities related to self-employment and micro-enterprise development. Where appropriate, the Field Business Centres should reach agreements with locally active NGOs to provide services through the FBC. Having these agreements tailored to the local level is preferred to having a Mahaweli-wide arrangement with one powerful NGO, as it reduces the political risk and increases the diversity of institutions. EIED and these NGOs could reach a mutually beneficial agreements on cost sharing in support of the activities.
- o **Private Associations.** The FBCs are currently active in forming credit societies and entrepreneur associations. In the future these associations can also serve as resources and means of outreach for the FBC.
- o **Other Government Agencies.** Inevitably, the Mahaweli area is becoming more closely integrated with local government structures and line ministry services. It will be the responsibility of the EIED field officers and the FBCs to facilitate and coordinate this process as it pertains to enterprise development.

Weaknesses of the Public Sector Option

The weaknesses from a the point of view of sustainability are the usual problems of public sector institutions in many contexts; the lack of incentives in compensation packages, bureaucratic procedures, personnel shifts regardless of training, talent, or interest, changing priorities and politics, lack of resources (other than salaries), and lack of commitment.

Through an effective program of staff training, measures to continue to increase operating efficiencies and a carefully orchestrated phased turnover of the FBCs to the best and brightest of EIED's already strong field staff, the Field Business Centres would operate effectively. But for how long? The EIED field staff will be tempted by outside opportunities. They will bit by bit be replaced by staff who did not experience the training, management system and so on under MED. The Mahaweli Authority may in the future be reorganized, and government and donor priorities may change. As a public sector institution, the FBC will continue to be supported for as long as government policy encourages rural micro-enterprise development and contract outgrower programs.

Private Sector Options and Variations

As stated earlier, nowhere in the world do small business centers aimed at helping new and small entrepreneurs, survive entirely from their fees for service. Therefore there is little reason to expect this to occur in the Mahaweli. However, we should consider at least how similar services might be provided to some Mahaweli entrepreneurs from a private sector institution.

MED could consider assisting the establishment of one or more private, for-profit firms, serving Mahaweli entrepreneurs and businesses in the nearby commercial towns. Obviously, such a firm would rely primarily on larger, non-Mahaweli clients, but could conceivably also provide services to some Mahaweli entrepreneurs, some of the success stories that may have grown larger in time. Such service would be supplementary to the services performed by the Field Business Centres. Some of the present MED Field Business Consultants may be interested in investing in such an operation. In discussions with field business consultants, we determined that a fully private FBC would have fixed costs, including good salaries, of approximately 80,000 rupees per month. Figures 2 and 3 show the calculations of monthly costs and capital costs. Figure 4 shows an optimistic estimation of revenue.

Whether or not such private business centers are viable commercial enterprises themselves is not clear. As with most entrepreneurship, there is a significant risk. Whether such enterprises are commercially viable and would still serve a Mahaweli clientele, directly or indirectly, or partially, is also not clear. The option should be explored during the remaining time of MED Project support.

The MED/EIED could support such a potential enterprise, as it does other potential enterprises, by working together with the potential entrepreneurs/investors (in this case some of its own employees/field business consultants) to design a pre investment program (PIP). Feasibility studies should be done to determine the strongest locations, the demand for different categories of services, and so on. An important factor to determine would be what percent of this private FBC's clientele would consist of Mahaweli micro and small enterprises. A small grant could help share the risk of a pilot operation.

A variant approach would negotiate for the private business service to share the space and use the facilities of the EIED FBC. This would reduce the monthly fixed costs of the private business service by approximately 30%, reducing the risk to the private business consultancy while at the same time providing an additional valuable and attractive resource to the EIED Field Business Centre. In exchange, the private business service would agree to provide a certain level of service and certain types of service to micro- and small enterprises of Mahaweli settlers. The private service might, for instance, take the responsibility for organizing and running the activities of the "Panel of Experts", which would likely include some of its chief clients from the nearby commercial centers. Additionally, the private service could offer special training courses and handle a certain targeted number of small business credit facilitations. The EIED officer would focus his or her attention on the Mahaweli clientele, providing direct services and coordinating activities of NGOs, government agencies, and this private business service which shares its official abode.

This option would give the EIED Field Business Centre a strong commercial character while still assuring that it serve in large measure the intended beneficiaries. It could also enhance the important linkages between the settler entrepreneurs and the wider economy as represented by the nearby commercial centers.

2.3 RECOMMENDATIONS FOR SUSTAINING THE FIELD BUSINESS CENTRES

MED/EIED should implement the program for strengthening the FBCs as EIED operated rural business centers. This recommendation includes the staff training program and the efforts to associate other institutions (Panels of experts, NGOs, private associations, government line agencies) with the FBC programs and increased emphasis on cost recovery and continued increase in efficiencies.

At the same time, MED/EIED should carry out feasibility studies for private, for-profit business service firms in certain of the most promising locations. Based on the results of these feasibility studies, MED/EIED should take steps to support the establishment of a private business service firm, or a hybrid public/private FBC, if either option still seems potentially viable.

Fig. 2. Private Field Business Center:

Estimated Monthly Expenditures

Salaries

Director	25,000
Deputy Dir.	15,000
Secretary	7,500
Cleaner, etc.	2,500
SUBTOTAL Salaries	50,000

Facility

Rent	5,000
Telephone	3,000
Electricity	1,000
SUBTOTAL Facility	9,000

Consumables

Stationary, Paper	1,000
Toner, ribbons, etc.	1,000
SUBTOTAL Consumables	2,000

Transportation

Maintenance, gas	4,000
Depreciation	1,000
SUBTOTAL Transport.	5,000

Capital Costs

Repayments on Rs. 500,000 Loan	14,000
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TOTAL MONTHLY EXPENDITURES	80,000
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Fig. 3. Private Field Business Center

Estimated Capital Costs

Computer	100,000
UPS	30,000
Printer	30,000
Photocopier	100,000
Fax	75,000
Typewriter	15,000
Telephone Installation	20,000
Key Money	50,000
Furniture and Misc. Small Equip.	15,000
Air Conditioning	65,000
TOTAL CAPITAL REQUIREMENTS	500,000
Borrowed for 5 years at 25% interest	
Monthly Payments	14,000

Fig. 4. Private Field Business Center

Estimated Monthly Revenues

Secretarial and Communications Services (Telephone, Fax, Photocopy, Typing) Charges per page, per call etc.	20,000
Professional Services (Accounting, Audits, Preparation of Official Forms) Schedule of fixed prices for forms Monthly fees to handle enterprise accts. Audits charged per hour of labor	20,000
Business Advice and Consulting (Advice on taxes and regulations) Charged per hour of consultation	10,000
Credit Facilitation and Project Preparation Charged as a percentage of project or loan value	30,000
Training Courses Small fee charged to trainees	10,000
TOTAL ESTIMATED MONTHLY REVENUE	90,000

3. SUSTAINING ACCESS TO RURAL CREDIT

The sustainability of the MED rural credit program presents fewer difficulties and questions than does the sustainability of the Field Business Centres. The credit program was designed to maximize sustainability, and every indication is that it will leave behind a network of financially solid legal associations of entrepreneurs. In the course of implementation, the program has been tailored to the social and cultural patterns of Sri Lanka and the Mahaweli, adapting internationally proven principles of successful rural credit programs. The program, however, is in its infancy, and considerable institutional development work remains to be done before it fully achieves the desired sustainability.

There are two components to the MED/EIED credit program. The most important in terms of long term sustainability is the establishment of Savings and Credit Societies, which act as intermediaries between their 1,000 members and the rural banks. The other component is the facilitation of direct lending from rural banks to small enterprises. Additionally, the Field Business Centres assist entrepreneurs to secure loans from the Mahaweli Venture Capital Company, a subsidiary of the Mahaweli Authority of Sri Lanka.

The MED/EIED credit program, after only two years of operation by the end of 1993, has assisted over 2,200 entrepreneurs to apply for credit for starting up or expanding their enterprises. The total value of the loans is Rs. 54 million, or over US\$ 1 million. *

In this section, we will describe the components of the MED/EIED credit program and review and assess the plans for enhancing their sustainability.

3.1 SAVINGS AND CREDIT SOCIETIES

One of the critical issues addressed in the MED project paper was the problem of access of small scale entrepreneurs to credit. Pre-project surveys had found that three out of four small scale entrepreneurs considered lack of finance to be a major constraint to expansion. Therefore the Project Paper proposed that MED would reduce this constraint by facilitating the formation of entrepreneur associations which will access the banking system by borrowing as associations and relending to members. It was planned that this group lending would be collateralized by a fund consisting of members' savings matched by a USAID/MED grant. It was planned that 50 or 60 of these associations would be formed with approximately 10 members each.

MED/EIED developed a lending program along these lines, based on extensive surveys as well as negotiations and discussions with banks, lawyers, and USAID.

There are now 66 Savings and Credit Societies with a total of over 1,000 members. After being formed with the assistance of the Field Business Centre, each Savings and Credit Society is registered as a legal entity which then signs an agreement with a local bank. To date agreements have been reached with four rural credit institutions: People's Bank, Bank of Ceylon, Regional Rural Development Banks of Polonnaruwa and Nuwara Eliya. One key to sustainability is institutional diversification. Should one bank lose interest in this program, the others may continue.

The banks make market rate business loans not to exceed Rs. 50,000 directly to individual members of the SCS. The loans may be for fixed or permanent working capital, and are for a term of between two and three years. The loans to individual members are collateralized by funds deposited to a special Collateral Fund Account. This collateral fund account consists of SCS members' contributions to the SCS's share capital plus a matching grant from MED equal to 1.5 the value of the members' contributions. In addition to the collateral fund, each individual lending project must be approved by the SCS. Additionally, the banks often require guarantees to be provided by two individual members of the SCS, and for the borrower's assets in the investment project to serve as additional security.

Under these conditions, the banks require only that the collateral fund be equal to 20% of the total value of the loans. This system allows for tremendous leveraging of funds provided by USAID. The USAID/MED grant to each SCS is approximately \$2,000. For 66 SCSs, the total investment that will be generated by this lending scheme is as follows:

SCS MEMBERS' CONTRIBUTIONS	USAID MATCHING GRANTS	TOTAL VALUE OF COLLATERAL FUNDS	VALUE OF COLLATERALIZED BANK LOANS	VALUE OF BORROWERS' PROJECT EQUITY	TOTAL VALUE OF INVESTMENTS
\$88,000	\$132,000	\$220,000	\$1,100,000	\$1,100,000	\$2,200,000

Two issues are important here. First, a relatively small amount of donor funds support this significant lending program. For every \$1 of donor funds, \$17 of local resources are mobilized and invested in small and micro rural enterprises. This greatly reduces the dependency of the scheme on external support. Second, the banks and the SCSs, because of this gearing ratio, have a strong interest in high levels of loan repayment, which enhances the financial sustainability of the program.

To fully appreciate the sustainability aspects of the MED SCS program, one can contrast it with many of the rural credit programs operated by NGOs in Sri Lanka and elsewhere. Under these schemes, the donor funds usually provide a 100% (or at best 50%) guarantee for the SSE loans. These programs are thus totally dependent on external funding support. Furthermore, the lending agency has little incentive to press for repayment, since its money is fully guaranteed. (Even with a 50% collateral fund, the bank stands at little risk.) Such funds become rapidly decapitalized as both lenders and borrowers realize that collection is not a high priority. These credit programs soon grind to a halt. In a recent article in *The World Bank Research Observer* entitled "What Makes Rural Finance Institutions Successful", it is stressed that many donor sponsored rural finance operations have fallen substantially below expectations. Often they have "reached only a minority, often the wrong minority, of the rural population, generating unintended 'grants'...which are captured by wealthy and influential farmers."

The author, Jacob Yaron, reviews the experiences of four successful rural credit programs in Bangladesh and Indonesia to determine the factors responsible for success. He stresses two conditions which must be met by successful rural credit programs:

- o Financial sustainability; and
- o Substantial outreach to the target rural population.

The MED/EIED Savings and Credit Society program meets these two conditions. It encourages financial sustainability by (a) working with established credit institutions, (b) charging market interest rates that fully cover the lending institution's costs, (c) reducing the transaction costs (through the unpaid screening process by the SCS), and (d) providing incentives and enforcement mechanisms for repayment.

Regarding achieving substantial outreach, the 17:1 gearing ratio of donor funds to total investment, and the large number of SCSs provide outreach to a substantial number of Mahaweli entrepreneurs and aspiring entrepreneurs.

3.2 PLANS TO ENHANCE SCS SUSTAINABILITY

Unions of Savings and Credit Societies

MED/EIED plans to strengthen the Savings and Credit Societies in two ways before the end of the project support. First, in order to increase the financial leverage of the SCSs with banks, MED/EIED is encouraging the stronger SCSs to consider enlarging their membership from about 15 members to approximately 20. It is felt that this additional membership will significantly expand the outreach without jeopardizing the solidarity of the SCSs. It is felt that with only 10 to 15 members at present, the SCSs do not represent enough of a market or mobilize enough share capital to command attention from bank lending officers, once the project consultants are no longer there to intercede.

Additionally, the project has begun to organize a union of SCSs in each of the five Mahaweli areas. This union would consist of the president (or other chosen representative) of each of the constituent SCSs, and would meet once a month. Each SCS would cover the transportation cost of its representative to attend the meetings. The purpose of the union is to provide a forum for exchanging information and experiences in operating SCSs, and to provide a cost effective unit for receiving future training or technical assistance. Additionally, the union would have more influence in future negotiations with participating banks than would individual SCSs.

From the point of view of sustainability, the Unions would cost almost nothing to sustain, yet they provide obvious benefits to the member SCSs and as a point of contact and service delivery for government agencies, financial institutions, NGOs, or international donors. Most important, is that the Union, through its meetings and exchanges of information, would help individual SCSs avoid becoming isolated and inactive over time.

An Apex Institution?

Looking ahead, the MED/EIED credit advisors are concerned that in the future, these SCSs and their unions will need additional supervision and internal auditing arrangements, in order to function as effective financial mediation institutions. Whether these requirements might be met through an as yet undeveloped apex institution and what might be an appropriate structure for an apex institution are questions yet to be fully studied. They can only be addressed adequately after the formation of the unions and in discussion with unions.

The original plan for the operation of the SCSs envisioned that in addition to arranging for loans from the bank to their members, the SCS would itself borrow from the bank and on-lend small to its members. If this plan is implemented it will definitely require the establishment of a supervisory institution. However, if the SCSs avoid becoming financial institutions themselves, this would lighten the responsibilities of any proposed apex institution.

One suggestion is that the Mahaweli Venture Capital Company (MVCC) might function in such a capacity. The MVCC currently has share capital of approximately Rs. 12 million (\$240,000). At present it is prudently conserving its principle, and lending from its interest earnings. If it were integrated into the SCS framework, its capital could be used much as the USAID grants are now used, to match members' contributions and generate loans worth eight times its contribution. This would provide a significant increase in the MVCC's impact on Mahaweli rural credit. At the same time, it would put the MVCC in a position to provide the overall supervision and auditing assistance that will be needed by the SCSs.

Is the MED/EIED Saving and Credit Societies Model Replicable in Other Rural Areas?

The program could be adapted for the situations in other parts of the country, but one would expect significant variations. The strength of the MED program is that a small institution (the SCS) screens for credit worthiness, provides incentives and enforcement mechanisms for repayment, and thus reduces the banks's risk and transaction costs. The SCS is necessary and effective in the Mahaweli resettlement area, where more traditional and kinship based village institutions do not exist. Some of the successful rural credit institutions in Indonesia are able to use the traditional village institutions, and thus avoid the difficult and expensive task of institution building.¹⁰ The most important lesson from the MED/EIED program and from the successful rural credit programs in Bangladesh and Indonesia is that mechanisms and institutional forms must be developed slowly in full consultation with all participants, and with great sensitivity to the social and cultural context. The development landscape in many countries is littered with the wreckage of attempts to imitate in a wholesale fashion the Grameen Bank.

3.3 DIRECT LENDING FACILITATION

The majority of the MED-assisted rural lending to date have been direct loans to individuals, outside the framework of the Savings and Credit Societies. As of December 1993, over 2,000 individual loans with a total value of almost Rs. 48 million had been submitted to local banks. The preparation of these loan applications, including the related business advising, completion of the required feasibility studies and business plans, and the negotiation with the bank lending officers, comprise the most important and most valued services offered by the Field Business Centres to Mahaweli entrepreneurs. The support and recommendations to the banks of the Field Business Centre staff, who have direct knowledge of the entrepreneur and his business, raises the credit worthiness of the borrower in the judgement of the bank staff.

There are two levels of sustainability at issue here. On the level of the individual client (or beneficiary), these entrepreneurs have received assistance that should enable them to continue a fruitful relationship with the bank in the future, without further assistance. Many of these clients are first time borrowers, or first time borrowers for more complex projects. The experience of working with the FBC staff in preparation of the plans and documentation necessary for the loan, and the putting them into a businesslike relationship with a local banking institution, should enable them to continue to borrow and expand their enterprises in the future.

As for the continuation of such services to Mahaweli entrepreneurs in the future, this is directly tied to the issue of the sustainability of the Field Business Centres themselves. The program for enhancing the sustainability of the FBC, outlined earlier, would ensure that the program of individual loan facilitation could continue, although perhaps not at current levels.

3.4 RECOMMENDATION: COMPLETE THE REMAINING TASKS

In summary, there is a monumental institutional development task to be completed on three levels. The Savings and Credit Societies are still fragile, infant organizations. Viable new institutions cannot be set up quickly. It takes time for them to establish operating structures, time for their members to fully understand, accept and internalize the essential principles, time for leadership disputes to arise and be solved, and so forth. There is easily two more years of guidance and technical advice required in order for this system of Savings and Credit Societies to be fully sustainable.

1994 Continue to strengthen the SCSs. Much remains to be done. As of December 1993, 31% of the SCSs were not yet legally registered; 39% had not yet entered into agreements with banks; and 46% had not yet submitted loan applications. It will take the concerted efforts of the credit advisor and the staff of the Field Business Centres throughout 1994 and perhaps longer in order to have all 66 SCSs formed, registered, with their 1,000 members borrowing, investing, and repaying. Additionally, the SCSs will need monitoring and advice as they face inevitable issues such as mechanisms of repayment enforcement.

1994 Continue assistance to SCSs; and complete formal registration procedures for all.

Begin formation of five Unions of SCSs.

1995 Strengthen and assist Unions to become fully and effectively operational.

Address the issues of increased internal controls and supervision and also the possibility of establishing an apex institution.

1996 Strengthen and assist SCSs, Unions and, if appropriate, apex organizations to be fully operational.

Establish and institutionalize internal control systems.

4. OUTGROWER ARRANGEMENTS

With over 6,000 Mahaweli farmers engaged in contract farming, this mode has clearly been shown to be the most successful employment creation modality in the Mahaweli (with the exception of garment factories which employ about 7,000 persons). Furthermore, regarding incomes, it appears that many outgrowers increase their net incomes by at least as much as those who benefit from new jobs created in other kinds of enterprises. So far, the results of facilitating contract farming arrangements are the strongest of all MED activities, in terms of exceeding the original targets for employment generators.

The outgrower component of MED was part of the original project design. As a major component of the strategy for increasing investment in Medium and Large Scale Enterprises the Project Paper stressed that, "Although no sector is precluded from receiving MED support, ... it is expected that self-contained and outgrower farms will be the initial focus for MED" Furthermore, the technical annex of the Project Paper projected that half of the enterprises receiving assistance through MED pre-investment programs would be out grower operations. However, the estimates for job creation through out-grower schemes (1,412 jobs) failed to fully appreciate the potential of this mode of production.

By the end of 1993, twelve companies had outgrower contracts with a total of 6,474 Mahaweli farmers, up from 770 in 1989. The outgrower contracts were for growing seven specialty crops the main ones being -- gherkins and tobacco. These operations vary between 30 outgrowers and 1,150, with the average at about 500 outgrowers." Furthermore, preliminary analyses indicate that contract farming in the Mahaweli generates as much increased income to Mahaweli settlers as does either agribusiness employment or small enterprise development." The program has become a major force for crop diversification in the Mahaweli areas and has aroused interest in Sri Lanka as a key element of a strategy for crop diversification. The EDB reportedly is due to start a financial program to encourage similar outgrower schemes.

What is Contract Outgrower Farming?

Contract outgrower farming is an institutional arrangement between farmers and buyers in which farmers supply produce on their own farms according to specified production and management methods while buyers retain responsibility for marketing operations and technical assistance in production."

It is an intermediate system of production and marketing, between the "spot market" system and vertical integration, between a system whereby independent farmers independently grow and sell their produce, on one hand, and a system whereby agricultural laborers receive wages working for a large agribusiness operation. The advantages of contract farming to the large companies is that they are able to receive products of the specified quality and quantity without making the investment in large tracts of land and fixed labor costs. The advantage to the farmers is that they maintain their independent smallholder status based on our risk irrigated paddy production, but augment this by also producing a more risky specialty crop for which they have a certain

market. In retrospect, given the uncertainties of land registration and other risks inherent in investing in a remote area, it is not surprising that contract farming of specialty crops has attracted investors and farmers alike.

Contract farming has its potential disadvantages to companies and farmers. For farmers, a concern is that they will be exploited by the company by being under paid for their crop. As individual small farmers they are in a weak position to negotiate the most favorable rates. For the companies, a concern is that one provides technical assistance to farmers as to how to grow a particular specialty crop, as well as the implicit information that there is a market for this crop, and the following season, the farmers will find a way to grow the crop on their own and market it through other channels. The potential disadvantage of contract farming as a means of increasing Mahaweli employment and incomes is that it is a mobile activity (although less so than most assembly type inward investment). A contract farming operation can shift locale in response to many competitive factors. This raises questions about long term sustainability of this form of employment generation unless there are strategies to maintain and strengthen the competitiveness of growing in the Mahaweli as opposed to elsewhere. In a situation in which world agricultural markets are becoming increasingly open, a focus on strengthening competitiveness will be a key to the success of crop diversification as a strategy for employment generation and raising family incomes in the Mahaweli.

At present, MED/EIED play a facilitative role regarding outgrower arrangements. Headquarters staff in Colombo provide information and advice regarding outgrower opportunities to potential investors. The staff of the Field Business Centres facilitate arrangements at the local level, often acting as "go-between" among the company, the farmers or farmer organizations, and the Mahaweli system level officials. MED/EIED also provide links with scientific and technical capabilities, as for example in the current research program (arranged by MED/EIED to link five companies, two universities, and one association) of variety trials to identify measures to increase gherkin yields. The neutral role of "go-between" appears to be key to the continued growth of outgrower operations. The arrangement must suit both sides. If the facilitating agency sees itself as primarily representing the farmers, it is likely to demand terms that will persuade the company to set up operations elsewhere. On the other hand, if the arrangement is not satisfactory to farmers, companies will suffer from a lack of supply of the product. Future sustainability of increasing levels of contract farming in the Mahaweli depend in part on maintaining the participation of a neutral facilitating institution.

In terms of employment and income generation, contract farming is the most successful component of the MED/EIED program. MED/EIED facilitation has been important in establishing the competitiveness of contract outgrower systems in the Mahaweli area. Sustaining this stream of benefits is thus critical to the sustainability of MED investments. Ironically, it is the least understood component of the program, and the component where the steps needed to ensure sustainability are least clear.

Recommendation

MED/EIED are currently having discussions with outgrower based companies with a view to identifying and resolving present constraints and developing stronger facilitative services at the FBCs. These activities are mainly directed at the present Yala and forthcoming Maha seasons. As the next step in developing a program to sustain this component of employment generation, MED/EIED should arrange for a study of contract farming in the Mahaweli. The lessons from the literature on contract farming are that it works very well in some types of marketing situations and with certain types of crops, and not at all in other situations. Furthermore, these situations favorable to contract farming are very specific to a region, and are the result of the interplay of many variables.

On the basis of the study, MED/EIED should develop an action plan to maximize the sustainability of the outgrower program. It is important to stress that the goal is not necessarily to keep the present outgrower operations in the Mahaweli in perpetuity, but to establish a framework which can continue to facilitate new outgrower arrangements and to maintain the competitiveness of Mahaweli growers.

NOTES

1. Goldensohn, Max. Sustainability Assessment: MARD Project. December 1993.
2. Davenport, Thomas. Saving IT's Soul: Human-Centered Information Management. *Harvard Business Review*. March-April 1994.
3. Caveat. The estimated number of jobs created is a gloss on a complicated set of calculations that take into account assumptions regarding equivalencies among full time, part time, and outgrower activities; as well as assumptions about differential opportunity costs for different types of employment, and other factors.
4. These percentages pertain to numbers of jobs. If one considers the effects of the job creation on incomes, the benefits from outgrower schemes and small and micro enterprise would be more evenly distributed.
5. MED/EIED Annual Report 1993 (The relevant table is included as Annex A to this report.)
6. Again, these statistics on job creation are a gloss on a complex situation.
7. Santer, et. al. Principles for Effective Design and Management of Small Business Development Centers. GEMINI Technical Report No. 62. October 1993.
8. MED/EIED Annual Report 1993 (Relevant table is attached as Annex B to this report.)
9. Yaron, Jacob. What Makes Rural Finance Institutions Successful? in *The World Bank Research Observer*, vol. 9, No. 1 (January 1994), pp. 49-70.
10. Conzalez-Vega, Claudio and Rodrigo A. Chaves. Indonesia's Rural Financial Markets. A report for the Financial Institutions Development Project, Indonesia. October 1992.
11. MED/EIED Annual Report 1993 (The relevant tables are included as Annex C to this report.)
12. Kumar, Krishna, et. al. As Assessment of Sri Lanka's Agribusiness Program. A.I.D. Center for Development Information and Evaluation.
13. Rassas, Bechir. Contract Farming in the Horticultural Sector in Senegal. (Contract Farming in Africal Project). Institute for Development Anthropology. April 1988.

MAHAWELI BUSINESS CENTRE: GIRANDURUKOTTE	
1993 Target	Accomplishments
Create 75 full-time jobs in small enterprises and 75 in medium and large enterprises	Created 165 full time jobs in small enterprises
Deliver 150 business advisory consultations	Delivered 816 business advisory consultations
Serve 30 enterprise and entrepreneur clients	Served 222 enterprise and entrepreneur clients
Form 3 SCSs	Formed 3 SCSs
Disburse 1 grant to SCS	Disbursed 3 grants to SCS for Rs. 33,960
Arrange 10 loans to SCS members	Arranged 12 loans to SCS members for Rs. 498,000
Arrange 10 loans to non-SCS entrepreneurs	Arranged 42 loans to non-SCS entrepreneurs for Rs. 1,488,000
Transfer 15 commercial and industrial SSE plots	Transferred 308 commercial and industrial SSE plots
Deliver 6 special (ad hoc) courses for 120 people	Delivered 5 special (ad hoc) courses for 101 people, including 2 in credit
Conduct 1 EDP Training course	Conducted 2 EDP training courses
Submit 18 loans for Rs. 350,000 and disburse 9 for Rs. 300,000 through MVCC	Arranged 15 loans for Rs. 392,740 through MVCC

SMALL ENTERPRISES - CREDIT

Total Mahaweli		Total 1991	Total 1992	Total 1993	Project to date
Total loans submitted to banks	Number of loans	896	564	770	2369
	Value of loans (Rs. '000)	13005	13970	26991	53966
Direct loans submitted to banks for entrepreneurs	Number of loans	896	512	387	1795
	Value of loans (Rs. '000)	13005	12319	16460	41760
Direct loans received from banks	Number of loans	639	316	278	1233
	Value of loans (Rs. '000)	6227	6385	10584	23196
Loans submitted to MVCC	Number of loans	***	***	153	153
	Value of loans (Rs. '000)	***	***	5870	5870
Loans received from MVCC	Number of loans	***	***	44	44
	Value of loans (Rs. '000)	***	***	1481	1481
Loans submitted to banks for Savings and Credit Society members	Number of loans	Nil	52	230	285
	Value of loans (Rs. '000)	Nil	1651	9280	11060
Loans received by Savings and Credit Society members	Number of loans	Nil	34	94	128
	Value of loans (Rs. '000)	Nil	1243	3472	4715
Savings and Credit Societies	No. of societies formed	9	21	31	61
	No. submitted for registration	7	15	31	53
	No. registered	Nil	16	26	42
	Number of members	96	279	518	893
	Value of member equity (Rs. '000)	96	400	543	943
	Value of collateral funds (Rs. '000)	Nil	336	1256	1592
Grants to Savings and Credit Societies	Number of grants made	Nil	13	24	37
	Value of grants made (Rs. '000)	Nil	938	1598	2536
	No. of grants disbursed		8	55	63
	Value of grant disbursements (Rs. '000)	Nil	115	433	548

OUTPUT INDICATORS:
1. ENTERPRISES AND EMPLOYMENT

Total Mahaweli		Total 1991	Total 1992	Total 1993	Project to date
Total jobs created (including self, micro, small, medium and large enterprises, not including outgrowers and garments)	Full time	1336	1193	1168	3697
	Part time	807	690	882	2379
Total jobs created in self, micro and small enterprises	Full time	922	939	783	2644
	Part time	410	452	476	1338
Self employment opportunities created	Full time	625	447	180	1252
	Part time	145	195	99	439
Jobs created in micro and small enterprises of which	Full time	297	492	603	1392
	Part time	265	257	377	899
a) Jobs created by <u>start-ups</u> of micro and small enterprises	Full time	201	246	287	734
	Part time	198	112	86	396
b) Jobs created by <u>expansions</u> of micro and small enterprises	Full time	96	246	316	658
	Part time	67	143	291	501
Jobs created in agribusiness	Full time	397	96	187	680
	Part time	364	158	142	664
	Outgrowers	1453	3042	1154	5649
Jobs created in other MLEs	Full time	17	157	198	372
	Part time		80	264	344
Jobs created in garment factories	Full time		5153	1912	7065
	Part time			0	0.00
Clients assisted total		2079	2871	2620	3372
Aspiring entrepreneurs		750	782	585	977
Existing entrepreneurs		1329	2089	2035	2395
Women clients assisted (aspiring plus existing)		353	656	937	1850
Clients trained		1650	1413	2830	5893
Entrepreneur development training - number of participants trained		939	10	289	1238
Technical and other training - number of participants trained (ad-hoc training)		711	1403	2541	4655
Business consultancies		4775	6869	11003	22647
Business consultancies to women		675	1585	2240	4500

Outgrowers Contracted During 1992 and 1993

Company	Crop	B	C	G	H	UW	Total 1993	Total 1992
Ace						120	120	
Aitken Spence	Gherkin, Baby corn		231			193	424	237
CIC	Seed Chillie				140		140	
CTC	Tobacco. S.bean. Maize		235				235	240
	Tobacco				1148		1148	
Forbes	Gherkins, baby corn tobacco		278				278	2600
Sunfrost	Gherkin	400					400	390
Heron	Gherkin					30	30	
Pickle Packers	Gherkin			803	140	211	1154	1518
VVL	Gherkin		500		300		800	335
Infomatics	Cashew		433				433	
Intabex Lanka	Tobacco					1062	1062	na
Chas P. Hayley	Gherkin					250	250	150
TOTAL		400	1677	803	1728	1866	6474	5470

MED/EIED PUBLICATIONS AVAILABLE

Local Market for Pickled Products (December 1990)

Non Farm Small Scale Enterprise Credit on Selected Mahaweli Systems, Geoffrey Peters and M.W. Panditha (December 1990)

Crop Profiles - Spices, Herbs and Aromatics, L. Denzil Phillips (July 1991)

Study of the Tourism Development in the Uda Walawe (July 1991)

Potential for Silver Skin Onions in the Mahaweli, Walter Nueberg (August 1991)

Nursery Development of Papaya and Mango, Papaya Growers' Guide and Technical Notes for Business Plan for Mixed Fruit Cultivation Investment, Ben Hatfield (November 1991)

Dehydrated Fruit Processing Opportunities and Trends in Sri Lanka, Wanchai Somchit, (November 1991)

An Evaluation of the Entrepreneur Development Programmes, Dr. Susan Exo and Hina Shah, (December 1991)

Aromatics PIP Interim Report on Trials Establishment, Dr Thomas Davies (December 1991)

Agro-Business Financing Review, Dennis De Santis (December 1991)

Integrated Fruit Drying, juicing, Pulping project - Prep Feasibility Study, Michael Smedley, Ben Hatfield and Wanchai Somchit (December 1991)

Cold Chain Requirements for Uda Walawe, Fredrick E. Henry (March 1992)

Field Manual for Processing Tomatoes, Peter Florance (March 1992)

Processing Tomato Trials in Mahaweli System H, Peter Florance (March 1992)

Processing Tomato Trials in Mahaweli System C, Peter Florance (March 1992)

Dried Fruit Processing in the Mahaweli, Dr. Kamal Hyder (September 1992)

Feasibility Study on Commercial Potential of Snake Venoms in Mahaweli Systems, Anslem de Silva, (January 1993)

Census of Mahaweli Enterprises and Employment (January 1993)

Most publications are priced at Rs.100/-. The publications are available at the MED Office at 8th Floor, Unity Plaza, Colombo 4. (inquiries, Ph. 508682-4)

An EIED publication entitled - "Information Available for the Mahaweli Investor", is also available at the MED Office.

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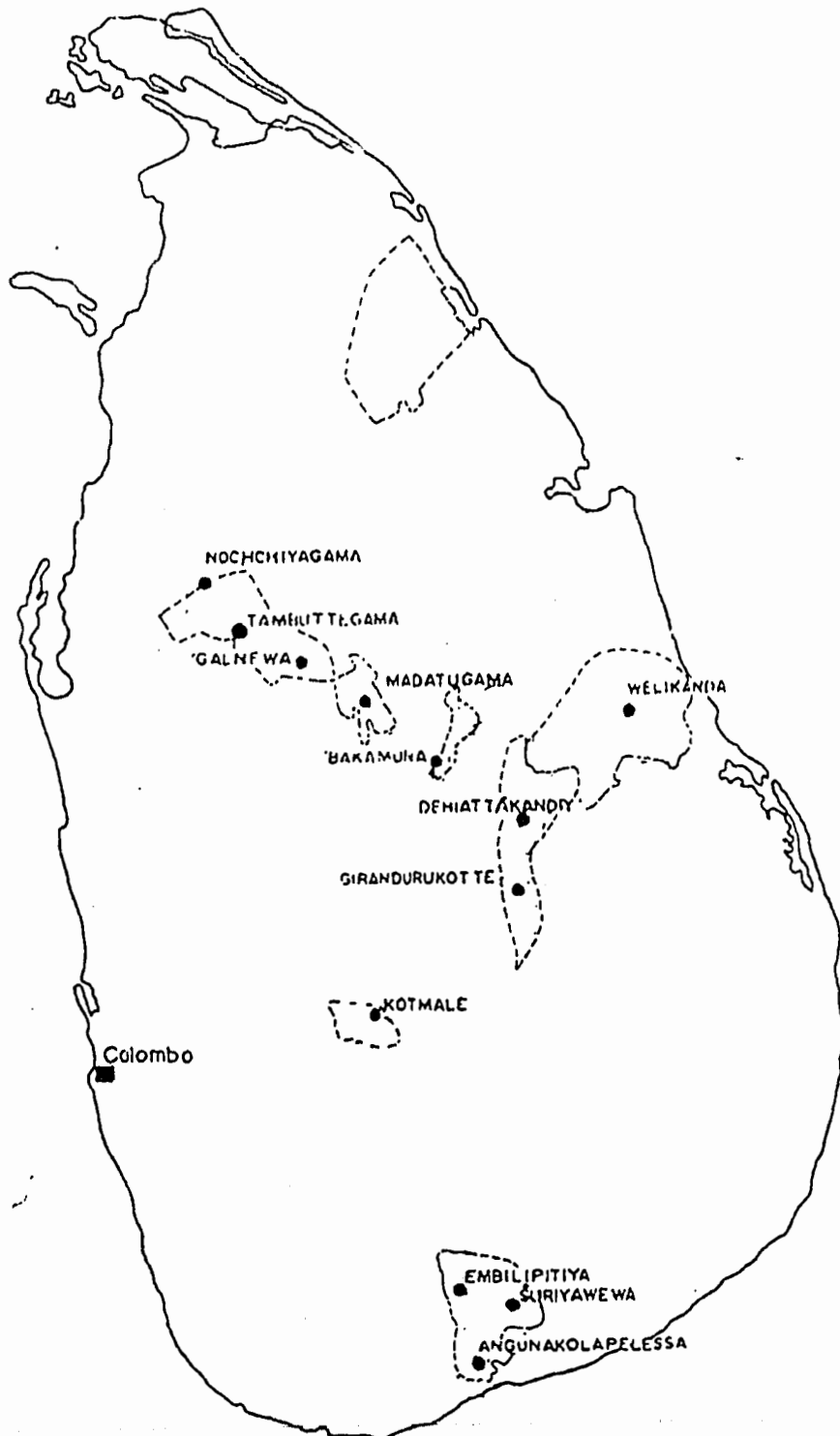
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MAHAWELI PROJECTS

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